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CITY OF WEST SACRAMENTO
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS
FOR THE YEAR ENDED
JUNE 30, 2008

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**CITY OF WEST SACRAMENTO
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS**

FOR THE YEAR ENDED JUNE 30, 2008

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MEMORANDUM ON INTERNAL CONTROL STRUCTURE

December 5, 2008

To the City Council of
the City of West Sacramento, California

In planning and performing our audit of the financial statements of the City of West Sacramento as of and for the year ended June 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, we noted no matters that we consider to be material weaknesses.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe to be of potential benefit to the City.

The financial statements of the City as of June 30, 2007 were audited by other auditors, and the Status of Prior Year Schedule of Other Matters and has been extracted from their report dated December 12, 2007.

This communication is intended solely for the information and use of management, City Council, others within the organization, and agencies and pass-through entities requiring compliance with generally accepted government auditing standards, and is not intended to be and should not be used by anyone other than these specified parties.

Maze & Associates

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**CITY OF WEST SACRAMENTO
MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

**SCHEDULE OF OTHER MATTERS
JUNE 30, 2008**

2008-01 – Information Technology Best Practices Recommendations

We conducted an Information Systems Review with our audit which encompassed the financial information system and the network environment that houses it. We expanded our work in previous years beyond simply looking at financial information systems as a result of greater risks of unauthorized access caused by overall industry growth of web-based commerce and internet based financial systems. Internal controls that are present in the overall network environment have become more important and relevant to understanding the internal controls over the financial system. We believe Information System controls must be continuously improved and enhanced to stay ahead of the ever increasing sophistication of hackers and criminals.

Currently, there are no Information Technology standards which local governments are required to conform to. Indeed there are a wide variety of informal guidelines and suggested controls from many different organizations which local governments can use to implement appropriate controls to ensure adequate security over information technology. Our Information Technology staff have reviewed these informal guidelines and concluded that the certification and accreditation framework developed by the National Institute of Standards and Technology (NIST) for the Federal Information Security Management Act (FISMA) are the most appropriate for local government. NIST and FISMA represent the minimum security requirements for federal government agencies information systems. We understand the U.S. Department of Justice recommends these for local governments. Our procedures included performing an external network scan based on NIST criteria and in determining that internal control provides for:

- Internet access defenses including hacker prevention, detection and deterrent systems
- Security of data from physical or network access
- Adequately protecting data from unauthorized internal access
- Reasonable measures to ensure continuation of service

While the results of our work did not indicate material weaknesses or significant exploitable vulnerabilities, we did note a few areas which could be improved to conform to NIST guidelines. A summary of these recommendations which we believe are “best practices” are as follows:

- *Payment Card Industry Compliance* - Any organization that processes credit cards is required to comply with the Payment Card Industry Data Security Standard (PCI-DSS), even if the processing is outsourced. The standard was developed to minimize the risk of loss due to security breaches in processing credit card transactions. Merchants which conform to the Standard pay lower transaction fees and minimize their liabilities which may result from security breaches than those that do not comply. The Standard requires varying levels of controls depending on transaction levels. In general, merchants must:
 1. Fill out a self-assessment questionnaire (SAQ).
 2. Submit the SAQ to acquiring banks.
 3. Perform quarterly external network scans and submit the results to acquiring banks.
 4. Have a full independent PCI audit performed by a Qualified Security Assessor (QSA) and submit it to acquiring banks. (Required for level 1 merchants only).

We believe the City qualifies as a Level 3 or 4 merchant due to activity levels of less than 1 million transactions and currently it need only complete and maintain the SAQ in-house. However, we understand SAQ submissions will become mandatory for Level 3 and 4 merchants in the near future. Staff have not completed the SAQ, but should do so and prepare for the submission requirement.

**CITY OF WEST SACRAMENTO
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**SCHEDULE OF OTHER MATTERS
JUNE 30, 2008**

- *Audit/Event Logging* - We believe this is one of the more important standards of NIST. The City does not appear to have audit logs documenting any change, addition or deletion of user accounts within the financial information system. The City should have audit/event logs of any addition, deletion or change in financial information system user accounts and the logs should be monitored by someone without the rights to effect such changes to ensure only authorized appropriate changes are made. In addition, any administrative access such as upgrades or application modifications by IT personnel, outside consultants or vendors should also be logged and reviewed.
- *General Information Systems Controls* - We compared the City's information systems controls with the various NIST standards and believe improvements should be considered for implementation such as employing Audit/Event logging, contingency planning and training and other areas. We have provided a detailed report to the City's Information Systems and Finance Staff which describes the control standards and the current status for their consideration.

As noted above, the City is not required to conform to NIST standards and could use another set of guidelines to ensure the adequacy of controls. However, we recommend the City select an appropriate industry standard such as NIST to plan, organize and monitor information security proactively.

Management's Response:

The City will implement the following recommendations:

- *SAQ:* The City will implement the self-assessment questionnaire.
- *Audit/Event Logging:* The City does track the changes/modification to the system through a program called IT Help Desk. The City will make changes to the program to include the recommendation from the auditors.
- *General Information System Controls:* Per discussion with Interim I.T. Manager, we noted the City is working on the issues of implementing contingency planning and training in other areas.

2008-02 – Purchase Orders

During our cash disbursement testing, we noted that the Receiving section of a Purchase Order is not consistently signed in every department. As per the City of West Sacramento Administrative Purchasing Policy, section E regarding Purchasing, all receiving orders should be signed by the department receiving the shipment. The effect of receiving orders going unsigned is that there is no proof that goods ordered are actually received; therefore the finance department could potentially be paying for orders that have not actually been realized. The cause of this, as per conversation with the accountant, is that the receiving orders are generated at a different location than a shipment's destination. In order to rectify this inconsistency, the Finance Department should not pay invoices for which there is not a signed receiving order.

Management's Response:

The City will immediately implement this comment. We are currently discussing the best way to implement this recommendation.

**CITY OF WEST SACRAMENTO
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**SCHEDULE OF OTHER MATTERS
JUNE 30, 2008**

2008-03 – Redevelopment Plan Compliance with Health & Safety Code §33333.2

The Redevelopment Agency did not submit its fiscal 2006/2007 independent auditor's report on the financial statements and legal compliance to the State Controller's Office and to the Agency Board within the required timeframe. In addition, the Agency did not submit its fiscal year 2006/2007 Financial Transactions Report to the Agency Board within the required timeframe.

In accordance with the Redevelopment Agency Compliance Guidelines, the required reports are due six months following the end of the Agency's fiscal year date (December 31, 2007). The Agency submitted its fiscal year 2006/2007 independent auditors report on the financial statements and legal compliance to the State and Board on March 19, 2008 and submitted the Annual Report of Financial Transactions State Controller's Office to the Board on March 19, 2008. The Agency could face action from the State Controller's Office if the reports are not submitted within the required timeframe. We recommend that the Agency submit all reports to the Board and State within the six-month requirement to ensure that the Agency does not face any action from the State Controller's Office.

Management's Response:

The 2006/2007 independent auditors report was not submitted to the State Controller's Office and the Agency Board before December 31, 2007 due to the final bound copy not being received until January of 2008. In the current year, the City sent a copy of the independent auditor's report to the State Controller's Office and the Agency Board before December 31, 2008. In the future, the City will work with the independent auditors to make sure reports are submitted to the proper agencies before the deadline.

2008-04 – Review of SAS 70 Reports

Union Bank of California, Bank of New York, U. S. Bank & Wells Fargo are the City's trustees. All of whom were engaged in SAS 70 audits for fiscal year 2008. However, the City has not reviewed the SAS 70 audit reports of these financial institutions. The purpose of the SAS 70 audit of an institution is to form an opinion of the institution's internal controls related to its processing of transactions for its custody services, security lending, and corporate trust department clients. We recommend that the City request the SAS 70 audit reports from the financial institutions annually and review the reports to ensure that the institution's controls are acceptable with the City's and industry standards.

Management's Response:

The City was not aware that the reviews of SAS 70 Reports are part of the internal control procedure. The City will contact Asset Management Company to determine if they are reviewing the SAS 70 reports.

**CITY OF WEST SACRAMENTO
MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

**SCHEDULE OF OTHER MATTERS
JUNE 30, 2008**

2008-05 - Upcoming GASB - Statement No. 49 - Accounting and Financial Reporting for Pollution Remediation Obligations (Effective for Fiscal Year 2008-2009)

This Statement addresses accounting and financial reporting for pollution remediation obligations (including contamination), which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. This Statement excludes pollution prevention and landfill closure or post-closure costs. A municipality must estimate expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:

- Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem.
- A government has violated a pollution prevention-related permit or license.
- A regulator has identified (or evidence indicates it will identify) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the clean up.
- A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution.
- A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

Liabilities and expenses would be estimated using an "expected cash flows" measurement technique, which is used by environmental professionals but will be employed for the first time by governments. Statement 49 also will require governments to disclose information about their pollution obligations associated with clean up efforts in the notes to the financial statements.

Pollution remediation outlays should be capitalized in the proprietary fund statements when goods and services are acquired if acquired for any of the following circumstances:

- a. To prepare property for sale. Capitalized costs (including pollution remediation costs) continue to be limited to lower of cost or net realizable value
- b. To prepare property for use when the property was acquired with known or suspected pollution that was expected to be remediated. Governments should capitalize only those pollution remediation outlays expected to be necessary to place the asset into its intended location and condition for use.
- c. To perform pollution remediation that restores a pollution-caused decline in service utility that was recognized as an asset impairment. Governments should capitalize only those pollution remediation outlays expected to be necessary to place the asset into its intended location and condition for use.
- d. To acquire property, plant, and equipment that has a future alternative use. Outlays should be capitalized only to the extent of the estimated service utility that will exist after pollution remediation activities uses have ceased.

For outlays under criteria a and b, capitalization is appropriate only if the outlays take place within a reasonable period prior to the expected sale or following acquisition of the property, respectively, or are delayed, but the delay is beyond the government's control.

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**SCHEDULE OF OTHER MATTERS
JUNE 30, 2008**

The Redevelopment Agency is planning to undertake a major project expansion and these requirements may be applicable and should be considered.

2008-06 - Upcoming GASB Statement No. 51, Accounting and Financial Reporting for Intangible Assets (Effective for fiscal 09/10) - Retroactive Application Required

Governments have different types of intangible assets, such as easements, water rights, patents, trademarks, and computer software. Easements are referred to in the GASB 34 description of capital assets, which has raised questions about whether and when intangible assets should be considered capital assets for financial reporting purposes.

The absence of specific authoritative guidance has resulted in inconsistencies in the recognition, initial measurement, and amortization of intangible assets among governments. The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets to reduce inconsistencies and enhance comparability.

A summary of the statement:

- Intangible assets should be classified, accounted for and reported as capital assets, unless excluded from the scope. Guidance in this statement is in addition to existing capital asset guidance.
- GASB 51 specifically addresses the nature of intangible assets.
 - *Lack of physical substance.* An asset may be contained in or on an item with physical substance, for example, a compact disc in the case of computer software. An asset also may be closely associated with another item that has physical substance, for example, the underlying land in the case of a right-of-way easement. These modes of containment and associated items should not be considered when determining whether or not an asset lacks physical substance.
 - *Nonfinancial nature.* In the context of this Statement, an asset with a nonfinancial nature is one that is not in a monetary form similar to cash and investment securities, and it represents neither a claim or right to assets in a monetary form similar to receivables, nor a prepayment for goods or services.
 - *Initial useful life greater than one year.*
- GASB 51 excludes:
 - Assets acquired or created primarily for the purpose of directly obtaining income or profit.
 - Assets resulting from capital lease transactions reported by lessees.
 - Goodwill created through the combination of a government and another entity.
- Recognition of an intangible asset occurs only if it is considered identifiable. That is when either of the following apply:
 - The asset is separable from the government. That is it can be sold, transferred, licensed, rented, or exchanged.
 - The asset arises from contractual or other legal rights, regardless of whether transferable or separable.

**CITY OF WEST SACRAMENTO
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**SCHEDULE OF OTHER MATTERS
JUNE 30, 2008**

- Specific conditions must be present to recognize internally generated intangibles. Capitalization of costs begins after all of the following criteria are met:
 - Determination of specific objectives of the project and the nature of the service capacity expected upon the completion.
 - Demonstration of the feasibility that the completed project will provide its expected service capacity
 - Demonstration of the current intention, ability, and effort to complete or continue development of the intangible asset.
 - Internally generated computer software is used as an example in applying the specific conditions approach.
- Amortization lives are addressed:
 - Limited by contractual or legal provisions.
 - Renewal periods for rights may be considered if there is evidence that the government will seek and be able to achieve renewal and that any anticipated outlays to be incurred as part of achieving the renewal are nominal. Such evidence should consider the required consent of a third party and the satisfaction of any conditions required to achieve renewal.
 - An indefinite life (no amortization) is permitted so long as there are:
 - No limiting legal, contractual, regulatory, technological, or other factors, and
 - No subsequent change in circumstances.
 - A permanent right-of-way easement is an example.

Retroactive Application. For GASB 34 Phase I & II governments, retroactive reporting is required for intangible assets acquired in fiscal years ending after June 30, 1980. Retroactive reporting is not required for intangible assets with indefinite useful lives or internally generated intangibles, as of the effective date of this Statement.

**CITY OF WEST SACRAMENTO
MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

**STATUS OF PRIOR YEAR SCHEDULE OF OTHER MATTERS
JUNE 30, 2008**

2007-01 – Investment Earnings Allocation

It appears the City allocated quarterly LAIF interest to funds during the year ended June 30, 2007 using monthly average cash and investment balances of the City's funds rather than quarterly average cash and investment balances, which may result in the allocation not appropriately being based on cash and investment balances held by each fund during the period the interest was earned. We understand the City is in process of updating software needed to provide the option to use quarterly average balances to allocate LAIF interest.

Current Status:

City launched a program that calculates interest allocation on 9 average monthly balance and average quarterly balance for LAIF. Corrected in the current year.

2007-02 – Account Detail

The Government Accounting Standards Board requires more detail of receivables than is currently recorded in the general ledger of the City and the current portion of long-term debt is not recorded in the City's general ledger, resulting in the need to make a number of reclassifications for reporting purposes. We recommend receivables and debt balances be reported in the general ledger consistently with how they are reported in the audited financial statements.

Current Status:

City budgets and records current portion of long-term debt. Detail of receivables are provided upon request.

2007-03 – Account Names

We noted the account names used for a number of debt discount, issuance cost and deferred charges and related amortization accounts are not consistent with the contents of the accounts, making classification difficult for reporting purposes. We recommend the City review the terminology used in the account names for these accounts to ensure they are consistent with the content of the accounts.

Current Status:

Due to the auditors trial balance program and account grouping, the reporting was difficult. The City is recording issuance cost and discount, deferred charges accordingly.

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CITY OF WEST SACRAMENTO
REQUIRED COMMUNICATIONS

December 5, 2008

To the City Council of
the City of West Sacramento, California

We have audited the financial statements of the City of West Sacramento as of and for the year ended June 30, 2008 and have issued our report thereon dated December 5, 2008. Professional standards require that we advise you of the following matters relating to our audit.

Financial Statement Audit Assurance: Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit in accordance with generally accepted auditing standards does not provide absolute assurance about, or guarantee the accuracy of, the financial statements. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is an inherent risk that material errors, fraud, or illegal acts may exist and not be detected by us.

Other Information Included with the Audited Financial Statements: Pursuant to professional standards, our responsibility as auditors for other information in documents containing the City's audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. Our responsibility also includes communicating to you any information that we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements. This other information and the extent of our procedures is explained in our audit report.

Accounting Policies: Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the City is included in Note 1 to the financial statements. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2008. As described in notes to the financial statements, during the year, the City implemented the following new standards:

CITY OF WEST SACRAMENTO

REQUIRED COMMUNICATIONS

JUNE 30, 2008

- **GASB Statement No. 45 - Accounting And Financial Reporting By Employers For Postemployment Benefits Other Than Pensions**

GASB 45 uses Pension Accounting (GASB 27) to change the accounting for Other Post Employment Benefits (OPEB) to full accrual at the entity-wide and proprietary funds financial statement levels. Under the concepts in GASB 45 an actuarial study or simplified measurement method calculation is performed to determine an Annual Required Contribution (ARC). So long as employers contribute this amount every year, no accrual adjustment is needed in the financial statements. A summary of the impacts of this statement are presented below.

As discussed in Note 11 to the financial statements, during the year ended June 30, 2008, the City contributed the ARC for fiscal 2007-08 by paying retiree health care premiums and paying additional contributions into a separate irrevocable trust established for the sole purpose of funding OPEB. This Trust is governed by a separate Board, which is not appointed or controlled by the City Council or management and it has therefore been excluded from the City's financial statements. In addition, the City transferred funds accumulated in prior years (termed the Net OPEB Asset) into the Trust. This Net OPEB Asset has been recorded as an asset and is being amortized over the actuarial amortization period. There was no cumulative effect of the accounting change as of the beginning of the year.

- **GASB Statement No. 48 – Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues**

The Statement establishes financial reporting of several categories of transactions. There was no cumulative effect on prior year financial statements. However, Note 7 to the financial statements was modified to include disclosures of revenue pledged for the repayment of debt.

- **GASB Statement No. 50 – Pension Disclosures – an amendment of GASB Statement No. 25 and No. 27**

This Statement amends current disclosures for cost sharing defined benefit pension plans by requiring among other things, funding trend data for cost sharing pools. Note 10 to the financial statements was modified and enhanced primarily by the inclusion of trend funding tables for the State-wide pools the City participates in.

Unusual Transactions, Controversial or Emerging Areas: No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2008. While there have been no changes in accounting policies or disclosures resulting from the credit crisis, we believe the unprecedented volatility of credit markets occurring after year end warrants mention.

Credit Risk and the Financial Crisis: The City has credit risks in one primary area of its operations: investments (Note 3). Credit risks as of June 30, 2008 for these areas have been disclosed in accordance with generally accepted accounting principals.

CITY OF WEST SACRAMENTO

REQUIRED COMMUNICATIONS

JUNE 30, 2008

However, subsequent to year end, financial markets experienced significant reductions of available credit and certain financial institutions have had their credit ratings downgraded with one large institution entering bankruptcy. The federal government has taken steps to support financial markets in an effort to stave off further negative trends. These conditions have increased credit risks which warrant continuous monitoring and reassessment of the risk that credit counterparties and investees maybe downgraded or be unable to fulfill their obligations. The City should place the highest priority on maintaining a credit watch on its counterparties and formulate contingency plans as needed to ensure credit remains available for its operations.

Estimates: Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. The most sensitive accounting estimates affecting the financial statements are as follows:

- *Estimated Fair Value of Investments:* (Note 3 to the financial statements) - As of June 30, 2008, the City held approximately \$181.4 million of cash and investments as measured by fair value. Fair value is essentially market pricing in effect as of June 30, 2008. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2008.
- Management's estimate of the depreciation is based on useful lives determined by management. These lives have been determined by management based on the expected useful life of assets as disclosed in Note 6. We evaluated the key factors and assumptions used to develop the depreciation estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.
- Accrued compensated absences is estimated using accumulated unpaid leave hours and hourly pay rates in effect at the end of the fiscal year. We evaluated the key factors and assumptions used to develop the accrued compensated absences and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Disagreements with Management: For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the City's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Retention Issues: We did not discuss any major issues with management regarding the application of accounting principles and auditing standards that resulted in a condition to our retention as the City's auditors.

Difficulties: We encountered no serious difficulties in dealing with management relating to the performance of the audit.

CITY OF WEST SACRAMENTO

REQUIRED COMMUNICATIONS

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Audit Adjustments: For purposes of this communication, professional standards define an audit adjustment, whether or not recorded by the City, as a proposed correction of the financial statements that, in our judgment, may not have been detected except through the audit procedures performed. These adjustments may include those proposed by us but not recorded by the City that could potentially cause future financial statements to be materially misstated, even though we have concluded that the adjustments are not material to the current financial statements.

We did not propose any audit adjustments that, in our judgment, could have a significant effect, either individually or in the aggregate, on the entity's financial reporting process.

Uncorrected Misstatements: Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We have no such misstatements to report to the audit committee.

This report is intended solely for the information and use of the audit committee, City Council, and management and is not intended to be and should not be used by anyone other than these specified parties.

Maye + Associates